DESCRIPTION OF ADDITIONAL TAX BILLS

(H.R. 4206, H.R. 4253, and H.R. 4271)

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON SELECT REVENUE MEASURES

of the

COMMITTEE ON WAYS AND MEANS

on November 3, 1983

Prepared by the Staff

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CONTENTS

	Page
INTRODUCTION	i
DESCRIPTION OF THE BILLS	1
1. H.R. 4206 (Mr. Archer, and others): Income tax exemption for military personnel killed in hostile actions overseas	1
2. H.R. 4253 (Mr. Dorgan): Tax credit or refund in connection with certain transportation expenses incurred with respect to employment at North Dakota anti-ballistic missile site	3
3. H.R. 4271 (Mr. Rostenkowski): Increase limitation on deduction for certain business gifts from $25 to $100	5

INTRODUCTION

This document contains descriptions of three bills (H.R. 4206, H.R. 4253, and H.R. 4271) listed for the November 3, 1983, hearing before the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means, as announced in the Subcommittee's press release dated November 2, 1983.

These three bills are in addition to the five bills (H.R. 677, H.R. 1607, H.R. 2568, H.R. 3030, and H.R. 3529) previously scheduled for the hearing. (The latter bills are described in the Joint Committee on Taxation staff pamphlet, JCS-54-83.)

DESCRIPTION OF THE BILLS

1. H.R. 4206--Messrs. Archer, Matsui, Hance, Anthony, Martin (N.C.), Ford (Tenn.), Frenzel, Thomas (Calif.), Vander Jagt, Gradison, Jones (Okla.) Moore, Campbell, Conable, Schulze, Duncan, Philip M. Crane, Fowler, and Stark, and Mrs. Kennelly

Income Tax Exemption for Military Personnel Killed in Hostile Actions Overseas

Present Law

Under present law, military personnel who die while serving in a combat zone, or as a result of wounds, disease, or injury incurred while serving in a combat zone, are exempt from Federal tax on income for the year of death and for any prior year ending on or after the first day such individual served in a combat zone (Code sec. 692(a)). The Congress has delegated the designation of "combat zones" to the President (sec. 112(c)(2)).[1]

In addition, if a serviceperson is reported in a missing status for a number of years, and it is subsequently determined that he or she actually died at an earlier time, there is no tax on income for years after the year of actual death. This exclusion for individuals who were in a missing status applies to the year of death and to years after death that precede and include the year of determination of death, but only for years beginning (1) on or before December 31, 1982, in the case of the combat zone designated for purposes of the Vietnam conflict,[2] or (2) within two years after termination of any other combat zone designation (sec. 692(b)).

Other Legislation

In 1970, the Congress enacted legislation treating individuals who had been removed from a U.S. vessel and who died while being illegally detained by the Democratic People's Republic of Korea during 1968 as serving in a combat zone (P.L. 91-235). Thus, service personnel who were members

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[1] Presidential designation of a combat zone entails other Federal tax consequences, including (1) exclusion from gross income of certain amounts of military pay of personnel serving there (sec. 112), (2) reduced estate taxes for personnel dying as a result of service there (sec. 2201), and (3) postponement of deadlines for filing returns, paying tax, and performing other acts for personnel serving there (sec. 7508).

[2] Vietnam became a combat zone as of January 1, 1964.

of the crew of the U.S.S. Pueblo, illegally detained in 1968 by North Korea, and who died during the detention were eligible for the income tax exclusion (and other special tax rules) available for service personnel who die in combat zones.

Under legislation enacted in 1980, if any American hostage held captive in Iran between November 4, 1979 and December 31, 1981 died as a result of injury or disease or physical or mental disability incurred or aggravated while in captive status, any income taxes imposed by the Code would not have applied with respect to the year in which the individual died or any prior year ending on or after the first day the individual was in captive status (sec. 202 of P.L. 96-449). This treatment would have applied to military and civilian personnel of the United States and to certain other individuals, as well as to certain other U.S. taxpayers taken captive outside Iran on or before December 31, 1981. Moreover, if there had been any unpaid income tax liability of such an individual from years prior to captivity, the liability would have been forgiven. This total income tax exemption for American hostages who died as a result of captive status would have been available only if death had occurred within two years after the individual ceased to be in captive status.

Explanation of the Bill

The bill would provide special income tax rules for certain individuals who die while in active service as a member of the Armed Forces of the United States.

If death occurs from wounds, disease, or injury incurred as a result of a hostile action outside the United States, then no U.S. income tax would apply for the year of death or for any earlier year ending on or after the first day the individual served outside the United States. In addition, any U.S. income tax for years preceding the year of first service outside the United States which is unpaid at the date of death (including interest, additions to tax, and additional amounts) would not be assessed. (If assessed, the assessment would be abated, and if collected, the liability would be credited or refunded as an overpayment.)

The rules of the bill would not apply to the extent that the combat zone rules of current law apply to the individual.

Effective Date

The bill would apply with respect to all taxable years (whether beginning before or after the date of the enactment of the bill) of individuals dying after December 31, 1979.

2. H.R. 4253--Mr. Dorgan

Tax Credit or Refund in Connection With Certain Transportation Expenses Incurred With Respect to Employment at North Dakota Anti-Ballistic Missile Site

Present Law

Present law allows a deduction for all ordinary and necessary expenses paid or incurred in carrying on a trade or business (Code sec. 162). Traveling expenses which meet these general requirements are deductible if incurred while away from home in the pursuit of a trade or business. For these purposes, traveling expenses include transportation fares as well as amounts expended for meals and lodging, other than amounts which are lavish or extravagant under the circumstances (sec. 162(a)(2); Treas. Reg. sec. 1.162-2(a)).

Traveling expenses are considered to be incurred while away from home in several different situations. One such situation is when the traveling expenses are incurred in connection with temporary employment and the taxpayer has a regular or principal place of business (or, in its absence, a regular place of abode) away from which the temporary employment takes place. The term temporary for this purpose generally is defined by the Internal Revenue Service and the majority of courts to mean employment which can reasonably be expected to last only for a short period of time. By contrast, traveling expenses incurred in connection with employment which is considered to be of indefinite or indeterminate duration generally are not deductible. On numerous occasions, the courts have considered the issue of whether a particular taxpayer's employment is temporary or indefinite in nature.[3]

In a 1979 case, Frederick v. United States,[4] the U.S. Court of Appeals for the Eighth Circuit upheld the District Court's ruling that a taxpayer's employment as a carpenter at an anti-ballistic missile project in Nekoma, North Dakota, during the years 1970 through 1973, was temporary and, therefore, that the taxpayer's associated transportation expenses were deductible. The District Court had reasoned that because of the seasonal nature of the employment and numerous lay-offs during construction, the taxpayer had

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[3] See, e.g., Peurifoy v. Commissioner, 358 U.S. 59 (1958); Kasun v. United States, 671 F.2d 1059 (7th Cir. 1982); Clark v. Commissioner, 46 T.C.M. 964 (1983); Blankenship v. Commissioner, 39 T.C.M. 91 (1979). See also Rev. Rul. 83-82, I.R.B. 1983-22, 5; Rev. Rul. 60-189, 1960-1 C.B. 60.

[4] 79-2 U.S.T.C. Para. 9529 (8th Cir. 1979), aff'g 78-2 U.S.T.C. Para. 9774 (N.D. 1978).

reasonably expected to be employed on the project for a temporary period only. The Internal Revenue Service has stated that it will not follow the Frederick decision outside the Eighth Circuit.[5]

Explanation of the Bill

The bill would provide a general statutory rule for the income tax treatment of certain traveling and transportation expenses incurred in connection with employment at the anti-ballistic missile project near Nekoma, North Dakota.

Under the bill, employment at the Nekoma anti-ballistic missile project would be treated as temporary, for purposes of the business deduction rules, with respect to transportation and traveling expenses meeting three requirements. These requirements are: (1) the expenses are otherwise deductible as a business expense under Code section 162(a); (2) the expenses were paid or incurred after 1969 and before 1975; and (3) the expenses were claimed on a tax return filed for any taxable year which includes any portion of the period described in (2).

If these requirements are satisfied, traveling and transportation expenses incurred in connection with employment at the Nekoma anti-ballistic missile project would be deductible under the business deduction rule permitting the deduction of certain expenses incurred in connection with temporary employment.

In addition, the bill would permit taxpayers who would be entitled as a result of its provisions to a credit of any overpayment or refund, but for the operation of another law or rule of law (including res judicata), to obtain the credit or refund by filing a claim for it within one year after the date of enactment.

Effective Date

The bill would apply retroactively to taxable years ending after 1969, with respect to expenses paid or incurred after 1969 and before 1975.

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[5] Rev. Rul. 80-333, 1980-2 C.B. 60.

3. H.R. 4271 -- Mr. Rostenkowski

Increase Limitation on Deduction for Certain Business Gifts from $25 to $100

Present Law

Code section 274(b) generally disallows business deductions for gifts to the extent that the total cost of all gifts of cash, tangible personal property, etc., to the same individual from the taxpayer during the taxable year exceeds $25. The statute expressly defines the term gift to mean any amount excludable from gross income under section 102 (relating to gifts and bequests).

The $25 limitation is increased in the case of business gifts of items of tangible personal property which are awarded to employees for certain purposes. Prior to enactment of the Economic Recovery Tax Act of 1981 (ERTA), this exception to the general $25 limitation applied to an item of tangible personal property only if the item's cost did not exceed $100, and only if the item was awarded to an employee by reason of length of service or for safety achievement.

ERTA increased the ceiling on deductions for business gifts to employees of items of tangible personal property in one year from $100 to $400 of cost for an item of tangible personal property which is awarded to an employee for the purposes specified in the statute. Also, ERTA expanded those purposes to include productivity, as well as length of service and safety achievement. Under these rules, a deduction is allowed up to $400 of cost of an item the cost of which exceeds $400.[6]

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[6] In addition, the amount of the allowable deduction for such business gifts was further increased by ERTA in cases where the item of tangible personal property is awarded for the specified purposes as part of a permanent, written plan or program of the taxpayer that does not discriminate in favor of officers, shareholders, or highly compensated employees as to eligibility or benefits.

A deduction is allowed for such plan awards of tangible personal property only if the average cost of all awards under all such plans of the taxpayer during the taxable year does not exceed $400. In addition, no deduction may be claimed under such an award plan or program for a particular item of tangible personal property awarded to an employee for such purposes to the extent that the cost of the item exceeds $1,600.

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Section 102 exclusion for gifts

Under Code section 102, gross income does not include the amount of cash, or the value of property, received by an individual as a gift. The U.S. Supreme Court has long held that this exclusion does not apply to property received in a business or commercial context if the item is intended as additional compensation for past or future services, regardless of whether the payor and recipient designate the transfer as a "gift" (e.g., Comm'r v. LoBue, 351 U.S. 243 (1956)).

In the leading case involving payments made "in a context with business overtones" (Comm'r v. Duberstein), the Supreme Court stated as follows with respect to distinguishing excludable gifts from includible compensation:

> "***(A) voluntary executed transfer of *** property ***, without any consideration or compensation therefor, though a common-law gift, is not necessarily a 'gift' within the meaning of the (income tax) statute. For the Court has shown that the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift. *** And, importantly, if the payment proceeds primarily from the 'constraining force of any moral or legal duty,' or from 'the incentive of anticipated benefit' of an economic nature***, it is not a gift. And, conversely, '(w)here the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it.'"[7]

Under Duberstein, the determination of whether property transferred from an employer to an employee (or otherwise transferred in a business context) constitutes a gift to the recipient is to be made on a case-by-case basis, by an "objective inquiry" of the facts and circumstances. If the transferor's motive was "the incentive of anticipated benefit," or if the payment was in return for services rendered (whether or not the payor received an economic

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[7] 363 U.S. 278(1960). In the Duberstein case, the Supreme Court upheld a Tax Court decision that an automobile given to the taxpayer by a business acquaintance was not excludable from income as a gift where the car was intended as remuneration for services rendered, even though there was no prior arrangement for compensation and the individual did not expect to be paid.

benefit from the payment), then the payment must be included in income by the recipient.[8]

Section 274(b) limitation on deduction

Section 274(b) generally limits to $25 the amount deductible (either as business or investment expenses) "for any expense for gifts made directly or indirectly to any individual ***." For this purpose, the statute expressly defines the term gift to mean "any item excludable from gross income of the recipient under section 102 which is not excludable from his gross income under any other provision" of the tax statute, subject to certain exceptions. Thus, section 274(b) comes into play in the case of a payment of cash or property which section 102 treats as a gift, and provides rules for whether such payments may still be deductible by the payor even though the equation is then "unbalanced," i.e., where a deduction to the payor is not fully matched by income to the recipient.

Section 274(b) was enacted by the Revenue Act of 1962. As passed by the House, the 1962 tax bill would have disallowed any deduction for business gifts exceeding $25 per recipient; there was no exception to this disallowance rule under the House bill for gifts of tangible personal property. The Senate Finance Committee amended the provision to add three exceptions to the $25 limitation, including an exception for an item of tangible personal property having a cost to the taxpayer (employer) not in excess of $100 if awarded to an employee by reason of length of service or safety achievement. The Finance Committee report on the 1962 bill states that this exception for certain business gifts of tangible property "relates only to deductibility by the employer" and "is not intended to have any effect in determining whether the employee who receives the award is to be taxed on its value."[9]

As described above, ERTA increased the ceiling on deductions for certain business gifts to employees of items of tangible personal property and expanded the purposes for which such gifts eligible for the increased deduction may be awarded to include productivity, as well as length of service

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[8] Under the Duberstein test, for example, the Tax Court has held that bonus payments made by an aircraft manufacturer to distributors based on the number of aircraft sold through their distributorships are not excluded from income as gifts, even though the manufacturer did not claim a business deduction for such payments, since the effect of the payments "was as an 'incentive of anticipated benefit of an economic nature'" (Hodge v. Comm'r, 32 CCH Tax Ct. Mem. 277, 283 (1973)).

[9] Sen. Rpt. No. 1881, 87th Cong., 2d Sess. 171 (1962).

and safety achievement. The legislative history of the ERTA provision, which was added to the bill by Senate floor amendment, reflects an intent to increase the original $100 tangible personal property deduction limit in view of the effect of inflation in the 20 years subsequent to enactment of that provision.[10]

Explanation of the Bill

The bill would amend Code section 274(b) by increasing from $25 to $100 the general limitation on the deductibility under sections 162 or 212 of all gifts of cash and property made to the same individual from the taxpayer during the taxable year. The amendment would not modify the exceptions to the general limitation which are enumerated in the statute (e.g., the special limitation on deductibility of gifts of certain tangible personal property awarded to employees for the specified purposes).

Effective Date

The amendment made by the bill would apply to gifts made after the date of enactment of the bill.

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[10] See 127 Cong. Rec. S-8640 (daily ed. July 28, 1981) (remarks of Senators Garn and Dole); Staff of Jt. Comm. on Taxation, 97th Cong., 1st Sess., General Explanation of the Economic Recovery Tax Act of 1981 179-180 (Comm. Print 1981).